VZCZCXRO7414
RR RUEHAST RUEHCI RUEHDBU RUEHLH RUEHNEH RUEHPW
DE RUEHBI #0328/01 2191236
ZNR UUUUU ZZH
R 071236Z AUG 09
FM AMCONSUL MUMBAI
TO RUEHC/SECSTATE WASHDC 7388
INFO RUEHBI/AMCONSUL MUMBAI 2613
RUEHNE/AMEMBASSY NEW DELHI 8615
RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEAIIA/CIA WASHDC
RHEHAAA/NSC WASHINGTON DC

UNCLAS SECTION 01 OF 03 MUMBAI 000328

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON EINV PGOV IN
SUBJECT: INDUSTRY DEBATES NEED FOR INCREASED FDI LIMITS AS REFORM BILL FACES DELAYS

MUMBAI 00000328 001.2 OF 003

¶1. (SBU) Summary: After years of fast-paced growth, the Indian life insurance industry saw a seven percent decline in premiums collected in 2008-09. Industry experts asserted that these declines were more the result of domestic factors such as the interest rate hikes in mid-2008 rather than the impact of the global financial crisis. India's biggest player, the state-owned Life Insurance Corporation of India, continued to lose market share to India's 21 privately-owned life insurers, whose premiums grew. While most industry insiders publicly support the Insurance Amendment Bill, which would raise the foreign direct investment cap from 26 to 49 percent, it has continued to take a back seat to other, more populist economic and social legislation in Parliament. Many industry representatives believe that some domestic partners, especially the more established firms, no longer need the additional foreign capital, and some may be working against the lifting of the FDI cap behind the scenes. However, the industry is united that other reforms introduced in the bill, including transforming the existing Insurance Regulatory and Development Authority (IRDA)into a full-fledged insurance regulator, are desirable. End Summary.

Growth in the life insurance industry impacted more by domestic conditions than the global crisis

----

¶2. (SBU) The insurance sector has been one of the success stories of India's economic reform process. According to IRDA data, annual life insurance premiums collected during the year 2008-09 fell to Rs.860 billion ($17.61 billion) from Rs.920 billion ($19.17 billion) in the previous year, a seven percent decline from the 36 percent growth seen the year before. Nevertheless, Peter Akers, India Head of Munich Reinsurance, pointed to data indicating that premium collections for all 21 privately owned life insurance companies grew; the lone exception was state-owned Life Insurance Corporation of India (LIC), the largest and the oldest life insurer. Marking the shift from government to private insurers, LIC saw its market share fall to 41 percent in 2008-09 from 48 percent the previous year. On the other hand, private life insurers increased their market share to 59 percent in 2008-09 from 52 percent in 2007-08.

¶3. (SBU) According to Prabhu, the decline in growth began before the onset of the global financial crisis, sparked by a series of interest rate hikes by the Reserve Bank of India (RBI) to control inflation in the summer of 2008. He explained that as increased interest rates removed liquidity from the capital markets, investors stopped contributing funds to from the most popular insurance investment plan know as Unit-Linked Insurance Policies, or ULIPs, which are essentially mutual fund investments. (Note: In simple terms, the stock and bond markets were declining, so investors could get better returns in short term saving deposits sponsored by banks. End Note.) After the RBI lowered interest rates to improve domestic liquidity conditions after the collapse of American investment bank Lehman Brothers, capital market conditions improved and investors returned to ULIPs . Binay Kumar Agarwala, Senior Vice President, ICICI Prudential Life Insurance, admitted that the life insurance sector had been growing too fast, and some moderation was needed. The crisis did not directly affect the balance sheets of insurance corporations, but hit growth, he added. Contrary to expectations, Prabhu added that even at the height of the financial crisis, domestic insurance companies were able to raise incremental capital from their foreign partners to meet solvency margins. (Note: Life insurance companies are mandated to maintain capital for a solvency margin of 1.5 times insured liabilities. End Note.)

Insurance Amendment Bill: Do Domestic Partners Really Want a FDI Hike?

¶4. (SBU) Insurance industry executives have publicly supported

the passage of the long-awaited Insurance Amendment Bill, which, among other things, would raise the sector's foreign equity cap from 26 to 49 percent. Considered by conventional wisdom the easiest of the reform measures to pass, the Congress Party has still not introduced the bill to Parliament for a vote, sparking speculation about the Indian government's commitment to this and other reform objectives. According to Akers, not all domestic players see the increase in FDI as advantageous at the moment. (Note: Of India's 21 privately-owned insurance companies, only two, Sahara and Reliance, do not have foreign joint venture partners. End Note.) He explained that in the initial stages of the insurance business, companies needed capital for marketing, infrastructure and personnel to build out their sales networks. As companies grew, so did steady streams of premiums and investment incomes, making major capital expenditures less important. Accordingly, newer entrants need large capital infusions, but established players are less interested in - and in some cases, may oppose -seeing the FDI cap raised. For example, Puneet Nanda, Executive Vice President of ICICI Prudential Life Insurance, the largest private life insurance company, noted that while 60 percent of total premiums came from new business two years ago, that figure is now only 45 percent. (Note: While ICICI claims that the decrease in new premiums collected as a percentage of overall premiums is an indication of a maturing business model, it can also be taken as an indication that premium collection slowed because of external conditions, not market maturation. End note.) Nanda affirmed that raising the industry's FDI cap was still welcome, but no longer necessary. Indeed, Akers insisted that the domestic partner of at least one major joint venture was currently lobbying against the hike in capital, while the foreign partners were lobbying for it.

¶5. (SBU) If they cannot block the bill as a whole, opponents may introduce amendments which dilute the FDI cap measure. The bill typically must go to the Finance Standing Committee for

comments before Parliamentary consideration, providing an opportunity for edits. Saibal Choudhury of MetLife Insurance suggested opponents want to include portfolio investment under the raised FDI cap. Competition with Foreign Institutional Investors (FIIs) for additional shares would make it more difficult for the foreign partner to acquire the full 23 percent. (Note: Some joint venture contracts specify that the domestic partner is obliged to sell an additional 23 percent equity to the foreign partner when the cap is raised, and some contracts specify the price. Because no insurance companies are publicly traded, an outside party like an accounting firm or an investment bank would otherwise be needed to value the firm before any stake sales take place. End Note.) Even if the foreign partner acquires all 23 percent, the option to sell to FIIs may enable the domestic partner to bargain for a significantly higher price. Choudhury stated that foreign players would interpret this as a broken promise on the part of the GOI, and implied that inability to raise their stake to 49 percent may diminish interest in supplying more capital to the industry.

¶6. (SBU) Another key amendment in the bill proposes to increase the powers of the Insurance Regulatory and Development Authority (IRDA). This move would enable the IRDA to become an independent and authoritative regulator similar to the Securities Exchange Board of India (SEBI). Their current lack of regulatory discretion is considered problematic by most industry observers. For instance, Reliance Life Insurance was planning to raise capital through an IPO. However, IRDA rejected this proposal stating the rule that Indian promoters having more than a 26 percent stake in an insurance company could reduce their holdings only after a waiting period of 10 years, or they would have to seek ask the government to reduce the waiting period. Akers noted that once the Insurance Amendment Bill was passed, IRDA could make the decision to reduce the waiting period instead of the government.

¶7. (SBU) At a recent seminar, IRDA chairman J. Hari Narayan said he expected the insurance bill to be passed this year, but admitted that the Bill lacked clarity on some issues. Though the Bill would raise the foreign direct investment cap to 49 percent, it is unclear which equity stake would be diluted should the joint venture list shares through an IPO. Narayan said that experts assume that the foreign partner will have to

dilute its stake, or it will have a controlling stake in the venture which may not be amenable to the Indian law. Agarwala of ICICI Prudential noted that this statement was taken by industry insiders as a sign that such a clause may be debated before the final bill is passed.

Re-insurers to be allowed to set up branch offices to conduct business

----

¶8. (SBU) Akers noted that one overlooked reform measure in the pending bill is that it allows reinsurance companies to establish branch offices in India. He explained that reinsurance allows insurers to securitize the largest and riskiest contracts taken by insurance companies. Under current legislation, domestic-foreign joint ventures in the reinsurance business were allowed, but none existed because Indian companies were not ready to commit the large amounts of capital needed to fund them. Reinsurers wanted to set up branches so that the risk could be transferred to the balance sheet of the global parent company, but under current legislation it would be on the

books of the Indian JV which would not be as well-capitalized as the foreign parent. As a result, large foreign reinsurers like Swiss Re, Munich Re, and Berkshire Hathaway only have back offices in India. All re-insurance business by the domestic insurance companies was done outside of India, leading to a capital outflow of reinsurance premiums. He added that General Life Insurance, the only Indian re-insurer predominately in the non-life segment and Hannover Re had announced a tie up but no business had been conducted yet.

¶9. (SBU) Comment: Over the past five years, insurance industry insiders have been stating publicly and privately that FDI caps needed to be raised to help accelerate growth, and have urged Parliament to pass this important reform legislation. Today, with many of these JV partnerships well-capitalized through consistent growth, some of the domestic partners claim to no longer need the additional foreign capital and as some believe, may not want to sell further equity stakes. Since some JV contracts require the Indian partner to sell equity to the foreign partner once the law changes, Indian partners may be reluctant to sell at the expected current valuation. However, it is a good reminder that in India, as elsewhere, there are often unseen interests and influences on every side of an issue, even those that seem to be "low hanging fruit," as this legislation has been frequently characterized. If the Congress continues to focus on populist - but inclusive - legislation and policies, such as additional rural spending, we should expect even the most sensible economic reform measures to take far longer to implement than expected. End Comment.
FOLMSBEE